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Supreme Court, U.S.
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No.

In the Supreme Court of the United States

OCTOBER TERM, 1993

FRANCIS and MARGARET PISCIOTTA,
PETITIONERS

v.

SMITH BARNEY SHEARSON

PETITION FOR A WRIT OF CERTIORARI TO THE DISTRICT OF COLUMBIA COURT OF APPEALS

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QUESTION PRESENTED

Do Sections 10(a) and 12 of the Federal Arbitration Act, 9 U.S.C. §§ 10(a) and 12, preclude an independent action to redress fraudulent conduct in connection with a securities arbitration proceeding, when the misconduct was concealed for more than three months after the arbitration award?

(II)

PARTIES TO THE PROCEEDING

The petitioners in this civil action are individuals, Francis Pisciotta and Margaret Pisciotta. Respondent is the brokerage firm Smith Barney Shearson, formerly Shearson Lehman Brothers.

TABLE OF CONTENTS

	Page
Opinion below	2
Jurisdiction	2
Statutory provisions involved.....	2
Statement.....	4
Reasons for granting the writ	21
Conclusion.....	34
Appendix A	1a

TABLE OF AUTHORITIES

Cases:

Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 910 F.2d 1049 (2d Cir. 1990)	26
Chestnut Hill Development Corp. v. Otis Elevator Co., 739 F. Supp. 692 (D.Mass. 1990)	25
Conley v. Gibson, 355 U.S. 41 (1957)	31

Cases - Continued:

	Page
Corey v. New York Stock Exchange, 691 F.2d 1205 (6th Cir. 1982)	29
Foster v. Turley, 808 F.2d 38 (10th Cir. 1986)	30
Grand Bahama Petroleum Co. v. Asiatic Petroleum Corp., 550 F.2d 1320 (2d Cir. 1977)	25
Meldeau International, Inc. v. Goodyear Tire & Rubber Co., 750 F. Supp. 1574 (S.D. Fla. 1990)	25, 26
Rodriguez de Quitas v. Shearson/American Express, 109 U.S. 1917 (1989)	22, 24
Shearson/American Express v. McMahon, 482 U.S. 220 (1987) 22, 23, 24	
Williams v. E.F. Hutton & Co., 753 F.2d 117 (D.C. Cir. 1985) 25, 33, 32	

Page

Statutes and rules:

9 U.S.C. § 10(a) 2, 26

9 U.S.C. § 12 ..3, 5, 8, 30, 31, 32

28 U.S.C. § 1257 2

Fed. R. Civ. P. 60(b) ... 9, 32

Miscellaneous:

Article III Section I of the NASD Rules of Fair Practice 12

Section 12(b) of the Uniform Code of Arbitration Procedure . 5, 6, 21

Section 32(b) of the Uniform Code of Arbitration Procedure . 13

Securities Arbitration, How Investors Fare, GAO/GG-92-74 at 18 (May 1992) 22, 24

District of Columbia Arbitration Act 31

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Francis Pisciotta and Margaret Pisciotta, by and through the undersigned counsel, respectfully petition for a writ of certiorari to review the judgment of the District of Columbia Court of Appeals in this case.

OPINION BELOW

The opinion of the court of appeals (App., infra, 1a-11a), is reported at 629 A.2d 520. The order of dismissal of the District of Columbia Superior Court, entered without opinion, is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 5, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

STATUTORY PROVISIONS INVOLVED

Section 10 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 10 provides:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration --
>
> (1) Where the award was procured by corruption, fraud, or undue means.
>
> (2) Where there was evident partiality or corruption in the

arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

Section 12 of the FAA, 9 U.S.C. § 12 provides:

Notice of a motion to vacate, modify, or correct an award must be served upon the adverse party or his attorney within three months after the award is filed or delivered. If the adverse party is a resident of the district within which the award was made, such service shall be made upon the adverse party or his attorney as prescribed by law

> for service of notice of motion in an action in the same court. If the adverse party shall be a nonresident then the notice of the application shall be served by the marshal of any district within which the adverse party may be found in like manner as other process of the court. For the purposes of the motion any judge who might make an order to stay the proceedings in an action brought in the same court may make an order, to be served with the notice of motion, staying the proceedings of the adverse party to enforce the award.

STATEMENT

This action is before the Court upon affirmance by the District of Columbia Court of Appeals of the dismissal by the District of Columbia Superior Court of a complaint brought by Francis and Margaret Pisciotta against Shearson Lehman Brothers (now Smith Barney Shearson). The case presents the issue of whether an independent action is available to a party to a securities arbitration who learns more than

three months after an award (the time under the Federal Arbitration Act, 9 U.S.C. § 12, to seek vacation or modification of an award in court) that the other party breached its contract to arbitrate in good faith and fair dealing, failed to provide truthful discovery, and knowingly used perjured testimony at the arbitration hearing.

Having learned more than three months after an arbitration award that Shearson knowingly used perjured testimony and denied proper discovery at an arbitration between them sponsored by the National Association of Securities Dealers ("NASD"), the Pisciottas brought a second arbitration proceeding to address not the matters which were the subject of the earlier arbitration submission but the wrongful conduct of Shearson during the arbitration. Pursuant to Section 12(b) of the Uniform Code of

Arbitration Procedure, Shearson requested that the NASD Director of Arbitration decline the use of its arbitration facilities for the Pisciottas' claims against it.[1] Approximately one year later, the Director notified the Pisciottas that the NASD was declining the use of its arbitration facilities to determine the dispute.

As the NASD declined use of its facilities to determine the merits of the Pisciottas' claims, the Pisciottas filed the

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[1] Section 12(b) of the Uniform Code of Arbitration Procedure provides:

> (b) Under this Code, the Director of Arbitration, upon approval of the Executive Committee of the National Arbitration Committee or the National Arbitration Committee, shall have the right to decline the use of its arbitration facilities in any dispute, claim or controversy, where, having due regard for the purposes of the Association and the intent of this Code such dispute, claim or controversy is not a proper subject matter for arbitration.

instant complaint in the Superior Court. The Superior Court dismissed the complaint without opinion. The District of Columbia Court of Appeals affirmed the dismissal, finding that the Pisciottas "exclusive remedy" was to seek to vacate or modify the original arbitration award and that the time to do so had lapsed.

However, the matters sought to be litigated were not part of the Pisciottas' original NASD statement of claim, the contractual subject of the earlier arbitration, and are matters which were not submitted to or decided by any arbitration. The matters sought to be litigated are not matters which are foreclosed from litigation by principles of res judicata or collateral estoppel. The complaint was timely filed for the causes of action stemming from the arbitration hearing, including breach of contract to arbitrate

in good faith and fair dealing, fraud, negligent misrepresentations and prima facie tort.

The conclusion by the court of appeals that the Pisciottas were barred from proceeding by the "exclusive statutory remedy," App. 1a-2a, is without proper foundation. The FAA is not by its terms an exclusive remedy. Nor does the FAA speak to the situation where, as here, the tortfeasor succeeds in covering up its fraudulent conduct for more than three months after an award. Therefore, in addition to reading into the FAA an exclusivity of remedy provision, the court of appeals has postulated a discovery rule for 9 U.S.C. § 12. App. 5a n.6. The correct interpretation of the FAA was raised before the lower courts as evidenced in the court of appeals' opinion and is the matter sought

to be determined here.[2]

For further understanding of the dispute, the factual allegations of the complaint, ¶¶ 5-16 are set forth hereat:

"5. In 1986, the Pisciottas and Shearson contracted to arbitrate a dispute involving Shearson and its then registered representative Elizabeth P. Christianson ("Ms. Christianson"). The dispute arose because Shearson paid the Pisciottas more than $178,000 less for zero coupon bonds than the values Shearson had placed on the bonds and Dr. Pisciotta's instructions, and because Shearson had executed a sale of stock in Richardson Vicks in a manner contrary to Dr. Pisciotta's instructions which netted the Pisciottas more than $5600

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[2] The Pisciottas would analogize the situation to Fed. R. Civ. P. 60(b) which permits motions to set aside judgments for fraud within one year but does not limit the power of a court to entertain an independent action for that purpose.

less from the sale. The Pisciottas sought damages in excess of $183,000, treble damages, punitive damages, interest costs and attorney's fees.

6. One cause of action in the Statement of Claim sought damages for violation of RICO. To establish a RICO claim, the Pisciottas needed to demonstrate a "pattern of racketeering activity." A "pattern of racketeering activity" requires the commission of two or more acts of "racketeering activity." Predicate acts under RICO include wire fraud, as well as mail fraud and fraud in the sale of securities. Violation of RICO provides treble damages and attorney's fees.

7. Shearson breached its contract to arbitrate with the Pisciottas in good faith and fair dealing. Shearson breached its contract to arbitrate with the Pisciottas in observance of high standards of commer-

cial honor and just and equitable principles of trade. Shearson purposefully breached its contract to arbitrate with the Pisciottas with intent to hinder and defraud the Pisciottas and the arbitration panel. Shearson's breach of contract was intentional, malicious and willful.

8. During prehearing discovery and at the hearing sessions held on March 18, 1988 and April 12, 1988, Shearson deliberately and improperly withheld information from the Pisciottas and the panel of arbitrators that Ms. Christianson had left the employ of Shearson because she had stolen large sums of money from various clients, had falsified documents and was under federal criminal investigation. Instead, Shearson, having by its Statement of Answer established a credibility dispute and denying liability under RICO, permitted Ms. Christianson to testify under oath that she

had left Shearson for "personal reasons" and advanced her credibility in opposing Dr. Pisciotta's testimony. Shearson intentionally omitted facts about wire fraud which would be predicate acts of racketeering activity for the Pisciotta's RICO claim.

a. Shearson misrepresented to the Pisciottas and the NASD by letter dated October 19, 1987, that it would "conduct this arbitration in as fair and equitable a manner as possible, consistent with NASD guidelines, including the exchange of relevant documents." Instead, Shearson did not conduct the arbitration in as fair and equitable a manner as possible, consistent with NASD guidelines, including Article III Section I of the NASD Rules of Fair Practice, and did not exchange relevant documents.

b. Although required by Section 32(b) of the Uniform Code of Arbitration to cooperate in the voluntary exchange of documents and information, Shearson concealed the true facts as to Ms. Christianson by refusing to provide [relevant information] called for by the Pisciotta's requests dated October 1, 1987 for:

> 1. All Hutton documents pertaining to Elizabeth P. Christianson regarding, reflecting, or constituting her personnel file, employment applications, hiring, knowledge, training, experience, ability, character, work habits, employment status, discipline, performance, evaluations, sale methods, revenue generated, salary, commissions, bonuses, other income, investigations, promotions, commendations, transfers, warnings, censures, probations, suspensions, demotions, compliance with employment rules, compliance with securities and banking laws and/or regulations, and business or professional reputation.
>
> 2. All correspondence and a description of all communica-

> tions by any person associated with Hutton with any other person whether or not associated with Hutton regarding the performance of Elizabeth P. Christianson.

c. By letter dated September 10, 1987, to all members of the Securities Industry Conference on Arbitration, the Securities and Exchange Commission ("SEC"), the SEC advised with regard to discovery in securities arbitration (emphasis added):

> While the parties are expected to exchange documents informally, we understand that on occasion the parties refuse to turn over certain documents that are, in their view, privileged or irrelevant. Customer complaints and other documents evidencing supervision or lack of supervision of a registered representative, which are in the sole possession of the industry party and are often relevant to a complainant's case, should be turned over in a timely fashion. There is, however, no established enforcement mechanism to ensure that parties cooperate in document production. Although the failure to produce documents may be deemed inconsistent with

> SRO rules requiring that their members conform with just and equitable principles of trade, we are not aware of any disciplinary actions to enforce this obligation.

Notwithstanding the SEC's admonition, in response to the Pisciotta's subsequent requests for "[c]ustomer complaints and other documents evidencing supervision or lack of supervision of Elizabeth Christianson," [Shearson did not disclose, produce or turn over any such documents].

d. At the hearing on March 18, 1988, Shearson, not then representing Ms. Christianson, permitted her to testify that she left Shearson for "personal reasons." The fact was that Ms. Christianson was on suspension at that time as a result of her admission to the FBI that she had withdrawn client funds for her own use without their authorization.

e. Pursuant to a directive of

the panel of arbitrators at the March 18, 1988, hearing, counsel for Shearson and the Pisciottas were to "work out the document production" and, if unable to resolve the issues, were to "identify the ones that you can't agree on and send that up to the NASD" to be ruled on. Following the hearing, Shearson did not provide requested information. By letter dated April 7, 1988, Shearson did not provide "[c]ustomer complaints and other documents evidencing supervision or lack of supervision of Elizabeth Christianson" but instead stated that the request was "[o]posed as irrelevant," thus continuing to conceal material facts about Ms. Christianson.

f. At the hearing on April 12, 1988, Shearson represented to the panel that there were no customer

complaints or other documents evidencing supervision or lack of supervision of Ms. Christianson.

9. Subsequent to the conclusion of the arbitration, in which the Pisciottas were awarded forty thousand dollars ($40,000), and all claims against Ms. Christianson dismissed, Ms. Christianson pled guilty to a criminal information filed August 25, 1988, in federal court in Baltimore for activities for which Shearson knew she was being investigated at the time of the arbitration. The criminal information charges Ms. Christianson with engaging in a scheme to defraud investment clients beginning in about December 1986 and continuing thereafter to in or about January, 1988. The information charges that Ms. Christianson:

> did devise and intend to devise a scheme to defraud and to obtain money and property by means of false and fraudulent pretens-

es, representations, and promises from various investment clients.

10. On November 10, 1988, Ms. Christianson was sentenced to five years imprisonment, all but six months suspended upon conditions, including six months in a "jail type or treatment institution." Among the conditions were that Ms. Christianson "make restitution to Shearson Lehman Hutton, in the amount of the loss $484,833.00" and that Ms. Christianson "continue psychiatric treatment and counseling." Subsequently, Shearson made restitution to Ms. Christianson's father for monies she had stolen from her father and late grandfather prior to the arbitration. Hutton guaranteed the signatures necessary for Ms. Christianson to obtain the funds unlawfully.

11. Against this background, it is no less than shocking that respondents permit-

ted Ms. Christianson to testify that she left Shearson for "personal reasons," objected to discovery requests which would have disclosed the nature of Ms. Christianson's problems as "irrelevant," and argued Ms. Christianson's credibility to defeat the Pisciotta's claims, including their claim under RICO.

12. Although required to report promptly, it was after conclusion of the arbitration, in September, 1988, that Shearson began reporting Ms. Christianson's much earlier misdeeds to the "CRD," a source of information which is available to the industry and public.

13. In April 1990, the Pisciottas filed a Statement of Claim seeking to arbitrate their claims for breach of contract, including the implied duties of good faith and fair dealing; for fraudulent and negligent misrepresentation; and for prima

facie tort.

14. By letter dated August 10, 1990, Shearson requested that the Director or Arbitration decline the use of the NASD's arbitration facilities to adjudicate the Pisciottas claim. In its letter, Shearson asserted that "no known charges existed against [Ms. Christianson] at the [time of the hearings on March 18 and April 12, 1988]." In fact, Shearson had admitted to the "CRD" that it was aware of a complaint in December 1987 that Ms. Christianson had misappropriated $194,609.77 from the account of an estate and that it had suspended Ms. Christianson in late 1987 as a result of her admissions to the FBI that she had withdrawn other clients' funds for her own use without their approval.

15. By letter dated March 8, 1991, the NASD notified the Pisciottas' counsel that its Executive Committee had granted

Shearson's motion "to deny the use of [the NASD] forum as to your submitted claim pursuant to Section 12(b) of the Code of Arbitration Procedure," making action in this forum necessary and appropriate.

16. During the periods in which the Pisciottas' [claims] were submitted to the NASD, statutes of limitations were tolled under applicable rules."

As stated above, the complaint was dismissed by the Superior Court by order docketed March 12, 1992 and affirmed by the District of Columbia Court of Appeals by judgment entered August 5, 1993.

REASONS FOR GRANTING THE WRIT

From 1980 through 1990, the number of securities arbitration cases filed with self-regulatory organizations ("SRO") increased from 830 in 1980 to 5,332 in 1990, an increase of over 540 percent. United States General Accounting Office

Report to Congressional Requesters, Securities Arbitration, How Investors Fare, GAO/GGD-92-74 at 18 (May 1992).

Since the decisions in Shearson/American Express v. McMahon, 482 U.S. 220 (1987) and Rodriguez de Quijas v. Shearson/American Express, 109 U.S. 1917 (1989), securities customers who have signed predispute arbitration clauses have been compelled to arbitrate their claims even under the federal securities laws.

Three months after the conclusion in McMahon that the earlier mistrust of securities arbitration was no longer warranted, the Securities and Exchange Commission sent a letter to the Securities Industry Conference on Arbitration ("SICA") that highlighted problems with arbitration including problems with discovery:

> While the parties are expected to exchange documents informally, we understand that on occasion the parties refuse

> to turn over certain documents that are, in their view, privileged or irrelevant. Customer complaints and other documents evidencing supervision or lack of supervision of a registered representative, which are in the sole possession of the industry party and are often relevant to a complainant's case, should be turned over in a timely fashion. There is, however, no established enforcement mechanism to ensure that parties cooperate in document production. Although the failure to produce documents may be deemed inconsistent with SRO rules requiring that their members conform with just and equitable principles of trade, we are not aware of any disciplinary actions to enforce this obligation.

Complaint ¶ 8(c) (emphasis added). The lack of a meaningful method to ensure appropriate discovery is the problem which is at the root of this case and fundamental to the integrity of the arbitration process. Indeed, it was not long after Shearson argued to this Court in McMahon that the Court should embrace securities arbitration that Shearson was committing

fraud in its arbitration with the Pisciottas.[3]

There are two lines of cases which deal with second proceedings following an arbitration. One line of cases, upon which the Pisciottas rely, analyze the second proceeding in terms of res judicata and collateral estoppel. Pursuant to this line of cases, if the matter sought to be liti-

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[3] Although the Pisciottas voluntarily submitted their claims to arbitration relying on the integrity of the process, there is no difference in procedure between voluntary and mandatory securities arbitration. With regard to mandatory arbitration after McMahon and Rodriguez the GAO Report, supra, stated at 52:

> Eight of the 13 investors [interviewed] told us they generally viewed the current mandatory binding arbitration system as unfair. Individual investors generally described the current system as biased, self-serving, and not in the best interest of the individual investor. One investor said that investors do not realize how unfair mandatory binding arbitration is until they go through the process.

gated was not presented to and decided by the arbitrators in the earlier proceeding, the second action may proceed. See Williams v. E.F. Hutton & Co., 753 F.2d 117 (D.C. Cir. 1985) (arbitration can only be preclusive as to claims actually submitted by agreement to arbitrators; claims which could have been presented but were not presented, and claims not covered by the submission agreement are not precluded); Grand Bahama Petroleum Co. v. Asiatic Petroleum Corp., 550 F.2d 1320, 1324 (2d Cir. 1977) (an arbitration award does not bar an action or further arbitration on an issue not before the arbitrators); Chestnut Hill Development Corp. v. Otis Elevator Co., 739 F. Supp. 692, 697 (D.Mass. 1990) ("[u]nlike a court's judgment, an arbitration does not foreclose consideration of an issue which might have been decided in the arbitration but was not"); see Meldeau

International, Inc. v. Goodyear Tire & Rubber, Co., 750 F. Supp. 1574, 1578 (S.D. Fla. 1990) (refusing to stay litigation of claims of tortious interference with business pending arbitration of breach of contract claims as the tort claims were not part of the submission to the arbitrators and the issue raised by the tort claim would not be addressed in arbitration). See also Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 910 F.2d 1049, 1056 n.4 (2d Cir. 1990), in which the court rejected an "exclusivity of remedy" argument under the FAA:

> Merrill Lynch's argument that Blumenthal and Fein are barred from seeking damages for wrongful injunction because their "exclusive remedy to challenge any aspect of the arbitration award was by a motion to vacate pursuant to sections 10 and 12 of the FAA: is unavailing. Plaintiffs are not challenging the arbitrators' award under the FAA, but are seeking compensation for damages, under the Federal Rules of Civil Procedure,

> caused by the wrongful injunction issued by the district court.

This line of cases, which the Pisciottas assert were correctly decided, would permit this action to proceed. There were two distinct set of wrongs committed against the Pisciottas, those prior to 1986 involving the pricing of bonds and the sale of Richardson-Vicks which were submitted to arbitration and those which began in 1987 when Shearson learned that Ms. Christianson was a thief. Complaint, supra at ¶ 8. Shearson knew that Ms. Christianson had stolen large sums of money through fraudulent means and had suspended her. Yet, instead of fulfilling its obligations to its customers, including the Pisciottas, by addressing Ms. Christianson's problems, Shearson determined to engage in a cover-up.

Although required to report the change

in Ms. Christianson's status promptly to the "CRD," a source of information available to the industry and public, Shearson waited until September, 1988, (three months after the award in the Pisciotta arbitration) to begin making any disclosure. Id. at 12. Rather than review customer accounts in light of Ms. Christianson's admitted problems with fraud and its responsibilities to deal fairly with its customers, Shearson concealed Ms. Christianson's wrongdoing.

Shearson had a strong motive for its cover-up. Not only did Shearson face potential liability for Ms. Christianson's acts of fraud, Ms. Christianson had admitted to predicate acts of racketeering, potentially exposing Shearson to treble damages and attorney's fees under RICO. See id. ¶¶ 6, 9, 10. And Shearson's complicity was not just passive: Shearson

(then Hutton) had guaranteed the signatures necessary for Ms. Christianson to steal from her father and grandfather. Id. at ¶ 10.

With regard to the Pisciottas, Shearson breached its responsibilities to them as customers, breached its duties to arbitrate in good faith and fair dealing, breached its obligations to provide discovery, and breached its obligations of candor. See id. ¶¶ 8(a-b). These are the wrongs which have never been heard and which should be permitted to be heard.

The second line of cases upon which Shearson and the court of appeals relies analyze second proceedings according to an "exclusive remedy" analysis. See Corey v. New York Stock Exchange, 691 F.2d 1205 (6th Cir. 1982) (complaints against New York Stock Exchange as sponsoring organization is impermissible collateral attack on

award); Foster v. Turley, 808 F.2d 38 (10th Cir. 1986) (claim filed in state court alleging same underlying agreement as was the subject of an arbitration subject to 9 U.S.C. § 12). While the court of appeals and other courts have used this analysis to prevent second actions from proceeding, no exclusivity provision appears in the FAA.

Moreover, to apply 9 U.S.C. § 12 to this case, the court of appeals presumed that a tolling provision would be written into 9 U.S.C. § 12, App. 5a n.6; that an amended complaint to encompass the after discovered fraud would be required to be heard in connection with the earlier arbitration submission, App. 10a; and that the second arbitration was a motion for reconsideration of the first, App. 6a n.7, a conclusion completely unsupported by the

record.[4]

Adoption of this second line of cases encourages fraud in arbitration proceedings. If the fraud is undetected, the wrongdoer wins; if the fraud is detected within three months, the proceeding may be vacated and simply reheard; if the fraud is detected more than three months later, the wrongdoer first argues that an appeal to the court is time-barred under 9 U.S.C. §

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[4] The court also declined to determine whether the District of Columbia Arbitration Act or the FAA applied. While the Pisciottas aver that the FAA clearly applies because interstate commerce is evident on the face of the complaint, for present purposes the FAA must be deemed applicable. The action is before the Court upon a motion to dismiss. This Court has long held that complaints may not be dismissed unless it appears that a plaintiff can prove no set of facts in support of their claim which would entitle them to relief. E.g., Conley v. Gibson, 355 U.S. 41, 45-46 (1957). Accordingly, if this issue is in doubt, for present purposes it must be resolved in the Pisciottas favor. Moreover, snuffing out the Pisciottas action under either statutory framework raises due process concerns.

12, and if heard insists that the original matter be relitigated. Where, as here, the victims were partially compensated at the first proceeding, the wrongdoer may prevail if the earlier award must be vacated and relitigated if the additional wrongdoing is to be addressed. Moreover, the "exclusivity" argument puts the focus on the wrong issues. The Pisciottas do not seek to relitigate the original Statement of Claim but to litigate different issues, including breach of contract to arbitrate in good faith and fair dealing, fraud, negligent misrepresentation and prima facie tort. The FAA does not create an exemption from normal common law remedies for such actions.[5]

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[5] Arbitration is a matter of contract. To work, each party must have an enforceable right to have their contract to arbitrate executed in good faith and fair dealing. This is especially so in securities arbitration. Unlike labor arbitration, securities arbitration rules are not negotiated between parties of comparable power with continuing relations which must

The conflict needing resolution can be illustrated by a comparison of the decision by the District of Columbia Court of Appeals in this case ("exclusive remedy") with the decision of the United States Court of Appeals for the District of Columbia in Williams, supra, 753 F.2d 117, 119 (the present claims may be barred only if they are covered by the statement of claim included in the Uniform Submission Agreement).

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be maintained. Deliberate fraud successfully covered up for more than three months should not be rewarded by "exclusive" application of 9 U.S.C. § 12. Appropriate comparison should instead be made to Fed. R. Civ. P. 60(b). Although judgments may be reopened only within one year for fraud, by its terms that rule does not limit the power of a court to entertain an independent action where fraud was involved.

The Pisciottas respectfully request that the Court consider this case to resolve these conflicting analyses and to resolve the issue of "exclusivity" of Section 12 of the FAA as a matter of statutory construction.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: November 3, 1993

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District of Columbia Court of Appeals

No. 92-CV-366

FRANCIS AND MARGARET PISCIOTTA, APPELLANTS,

v.

SHEARSON LEHMAN BROTHERS, INC., APPELLEE.

Appeal from the Superior Court of the District of Columbia

(Hon. John H. Suda, Trial Judge)

(Argued June 16, 1993 Decided August 5, 1993)

Arthur M. Schwartzstein for appellants.

Charles R. Mills for appellee.

Before FERREN, SCHWELB, and FARRELL, *Associate Judges.*

FARRELL, *Associate Judge*: This is an appeal from the dismissal of an action by which appellants sought damages for alleged misconduct by appellee, including fraud and breach of an implied duty of fair dealing, in the course of an arbitration proceeding. The arbitration resulted in an award for appellants, but they maintained in their suit that appellee's conduct had been designed "to hinder and defraud [appellants] and the arbitration panel," presumably resulting in an award less than appellants would have received but for the fraud and unfair dealing. Although appellants strenuously maintain that the damages they seek are unrelated to the size of the arbitration award, we conclude that what they have mounted is an impermissible collateral attack on the award in a manner that, if permitted, would circumvent the exclusive statutory rem-

edy by which such awards may be vacated on grounds of fraud and related conduct.

I.

In September 1986, appellants began a voluntary arbitration proceeding with the National Association of Securities Dealers (NASD), seeking damages from E.F. Hutton & Co. (now Shearson Lehman Brothers (Shearson)) as well as from Elizabeth P. Christianson, Hutton's representative in charge of appellants' securities account. In their Statement of Claim, appellants alleged (1) that Shearson/Hutton had purchased bonds from appellants for $178,398 dollars less than the value Shearson itself had placed on the bonds, and (2) that Shearson sold one thousand shares of stock for appellants for fifty dollars per share, contrary to appellants' instructions that the stock be sold when it reached fifty-five dollars per share.[1] In keeping with NASD's Code of Arbitration Procedure, each party signed a Uniform Submission Agreement to arbitrate the claim. On June 6, 1988, a three member panel of NASD arbitrators dismissed the claim against Christianson, but found Shearson liable to appellants for $40,000, which Shearson has since paid in full.

In April 1990, appellants filed a new arbitration claim, this time alleging that Shearson had breached its contract to arbitrate in good faith and consistent with its implied duty of fair dealing. Upon Shearson's objection that appellants were merely attempting to reopen the arbitration award, NASD refused to hear the claim as an improper subject for arbitration. Appellants then filed a complaint in the Superior Court on August 9, 1991, alleging that Shearson had committed "flagrant breach of contract, including breach of the implied duties of good faith and fair dealing; fraud, negligent misrepresentation, and prima facie tort . . . in connection with a

[1] Appellants alleged violations of federal securities laws and the RICO statute, fraud, breach of contract, negligent misrepresentation, breach of fiduciary duty and breach of NASD rules.

securities arbitration held in the District of Columbia." The complaint asserted that in pre-hearing discovery and during the arbitration hearing itself, Shearson intentionally withheld from appellants and the arbitrators information that Christianson had left Shearson not for "personal reasons," as she testified during the arbitration, but because she had stolen large sums of money from the firm, falsified documents, and was under federal criminal investigation.[2] Appellants further alleged that Shearson had acted improperly in permitting Christianson, who was represented by her own counsel, to testify that she had left Shearson for "personal reasons" and in arguing Christianson's credibility to the arbitrators. Appellants sought damages in an amount to be proven at trial, including punitive damages, costs and attorney's fees.

Shearson moved to dismiss the complaint under Super. Ct. Civ. R. 12 (b)(1) and (b)(6) for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted. It asserted that appellants' suit was an impermissible collateral attack on the June 6, 1988, arbitration proceeding because appellants had failed to challenge the arbitration award in the manner and within the time provided by the arbitration statutes. In opposing the motion to dismiss, appellants argued that their claims of fraud and misconduct were not within the scope of the original agreement to arbitrate and had not been considered — indeed, could not have been

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[2] Appellants claimed that both NASD rules and their discovery requests had required Shearson to release all information relating to Christianson. The complaint also alleged that "Shearson represented to the [arbitration] panel that there were no customer complaints or other documents evidencing supervision or lack of supervision of Ms. Christianson," despite the fact that Shearson knew she was being investigated for engaging in a scheme to defraud investment clients beginning in approximately December 1986 and continuing until January 1988. According to the complaint, Christianson was convicted on November 10, 1988, of charges arising from the investigation.

considered — in the original arbitration proceeding, and thus were properly before the Superior Court. The trial court granted Shearson's motion to dismiss.

II.

We have previously stated that "[t]he authority of courts to interfere in contractually mandated arbitration proceedings is governed by arbitration statutes." *Thompson v. Lee*, 589 A.2d 406, 410 (D.C. 1991). In this case, the parties do not join issue on which arbitration statute — the District of Columbia's or the federal statute — governs because appellants argue, despite the principle stated in *Thompson*, that neither statute applies to their suit for fraud and misconduct in the arbitration process.[3] In so contending, appellants attempt to turn what appears to be a fact destructive of their position to their advantage. They acknowledge that the arbitration statutes (both federal and local) provide an explicit remedy for claims that an arbitration award was procured by fraud or "undue means." They contend, however, that because the remedy furnished by the statute is inadequate to make them whole for Shearson's alleged misconduct or to deter parties like Shearson from breaching the implied agreement to deal fairly in the arbitration process, the statute must be read to leave intact appellants' common law right to sue for breach of contract and related torts in connection with the arbitration. We are unpersuaded by this argument.

Our decisions, like those of the federal courts, have emphasized the "fundamental and powerful" policy "embodied" in modern arbitration statutes that favors voluntary commercial arbitration "and narrowly constricts the scope of judicial in-

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[3] The Federal Arbitration Act applies to contracts "evidencing a transaction involving commerce." 9 U.S.C. § 2 (1988); *see Coles v. Redskin Realty Co.*, 184 A.2d 923, 926-27 (D.C. 1962). In *Thompson*, we expressed no opinion on whether jurisdiction under the federal statute would be concurrent with jurisdiction under the District's arbitration statute. 589 A.2d at 410 n.3. We need not decide that issue in this case either.

tervention" in such proceedings. *Hercules & Co. v. Shama Restaurant Corp.*, 613 A.2d 916, 922 (D.C. 1992) (quoting *Hanes Corp. v. Millard*, 174 U.S. App. D.C. 253, 267, 531 F.2d 585, 599 (1976)). Indeed, as we indicated in *Thompson*, *supra*, this policy dictates that courts may interfere with the outcome of arbitration only to the extent permitted by arbitration statutes. 589 A.2d at 410. The District of Columbia Uniform Arbitration Act[4] provides an explicit judicial remedy for the misconduct alleged in appellants' complaint. D.C. Code § 16-4311 (a)(1) states that, "[u]pon application of a party, the Court shall vacate an [arbitration] award where . . . [t]he award was procured by corruption, fraud or other undue means."[5] As we pointed out in *Thompson*, § 16-4311 (a)(1) "cover[s] fraudulent conduct that transpired during the arbitration proceedings." 589 A.2d at 412 n.7 (dicta). If it finds such misconduct, the court "may order a rehearing before new arbitrators chosen as provided in the [parties'] agreement . . . ." § 16-4311 (c). Importantly, however, the statute limits the time within which such claims may be asserted: "[a]n application under this section . . . , if predicated upon corruption, fraud or other undue means, . . . shall be made within ninety days after such grounds are known or should have been known." D.C. Code § 16-4311 (b).[6]

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4 D.C. Code §§ 16-4301 *et seq.* (1989).

5 The federal arbitration statute likewise provides that an arbitration award may be vacated "[w]here the award was procured by corruption, fraud, or undue means." 9 U.S.C. § 10 (a).

6 Although the federal statute does not incorporate in terms a discovery rule ("known or should have known") into its parallel three-month limitations provision, 9 U.S.C. § 12, it seems probable that courts will read one into the statute by implication for fraud-type claims. *See Foster v. Turley*, 808 F.2d 38, 42 (10th Cir. 1986); *see also Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946) (doctrine that limitation period is tolled where plaintiff has been injured by fraud and remains ignorant of it through no fault or lack of diligence on his part "is read into every federal statute of limitation").

Appellants concede that they took no action under the statute within this time period.[7] Thus, were we to allow their independent suit for fraud in the arbitration process, we would permit them to bypass both the express remedy in the arbitration statute for that conduct and, equally important, the express time limit within which such grounds must be asserted. We decline to do so and, instead, hold with other courts which have considered the issue that "[t]he Arbitration Act provides the exclusive remedy for challenging conduct that taints an arbitration award within the Act's coverage." *Foster v. Turley, supra* note 6, 808 F.2d at 41-42

Corey v. New York Stock Exchange, 691 F.2d 1205 (6th Cir. 1982), is the leading case holding that allegations of misconduct in the arbitration process do not make out an independent claim for which a court may award damages.[8] In *Corey*, the plaintiff-appellant sought punitive damages for alleged misconduct in the course of an arbitration proceeding that had been resolved in favor of his opponent, Merrill Lynch, Pierce, Fenner & Smith. After unsuccessfully suing Merrill

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[7] Appellants were aware of the alleged misconduct in April 1990 at the absolute latest, when they filed their second Statement of Claim with NASD. They filed their complaint in Superior Court on August 9, 1991, more than ninety days after they became apprised of the conduct forming the basis of their claim. They correctly make no argument that filing the second Statement of Claim tolled the limitations period under § 16-4311 (b). *See Tung v. W.T. Cabe & Co.*, 492 A.2d 267, 269-70 (D.C. 1985) (motion for reconsideration of arbitration award with NASD, which is not authorized under the NASD Code of Arbitration Procedure, does not toll the limitation period set forth in D.C. Code § 16-4311 (b)).

[8] *Corey* interpreted 9 U.S.C. § 10 (a), the federal counterpart to D.C. Code § 16-4311 (a). Because the District's arbitration statute and the federal act are "substantially similar," "federal court decisions construing and applying the federal arbitration act may be regarded as persuasive authority in construing and applying the corresponding provisions of the District of Columbia arbitration act." *Hercules & Co., v. Beltway Carpet Service, Inc.*, 592 A.2d 1069, 1072-73 (D.C. 1991).

Lynch and claiming that it had conspired with the New York Stock Exchange (NYSE) to deprive him of a fair arbitration hearing, the plaintiff sued NYSE alone, alleging that its assistant arbitration director, responsible for preliminary oversight of the arbitration between plaintiff and Merrill Lynch, had denied him a fair hearing by selecting biased members of the arbitration panel and rescheduling hearings over plaintiff's objections. The district court granted summary judgment in favor of NYSE. The Sixth Circuit affirmed, reasoning that 9 U.S.C. § 10 (a) provides the exclusive remedy for allegations that an arbitration award was tainted by misconduct committed during the proceeding. The court explained:

> Corey's claims constitute a collateral attack against the award even though Corey is presently suing a different defendant than his original adversary in the arbitration proceeding and is requesting damages for the acts of wrongdoing rather than the vacation, modification or correction of the arbitration award. . . . Corey's complaint has no purpose other than to challenge the very wrongs affecting the award for which review is provided under section 10 of the Arbitration Act. The mere presence of the NYSE, Cavell [the assistant arbitration director] or the arbitrators or the prayer for damages does not change the substance of his claim. Very simply, Corey did not avail himself of the review provisions of section 10 of the Arbitration Act and may not transform what would ordinarily constitute an impermissible collateral attack into a proper independent direct action by changing defendants and altering the relief sought.

Id. at 1213. The court further reasoned that "[t]he three month notice requirement in section 12 [corresponding to D.C. Code § 16-4311 (b)] for an appeal of the award on section 10 or 11 grounds is meaningless if a party to the arbitration

proceedings may bring an independent direct action asserting such claims outside of the statutory time period provided for in section 12." *Id.*

Similarly, in *Foster v. Turley*, *supra* note 6, the court held that 9 U.S.C. § 10 (a) provides the exclusive remedy for a claim that a party's failure to disclose material facts during an arbitration proceeding tainted the award. "Contracts to arbitrate are not to be undermined by allowing one party to ignore the contract and resort to the courts. When, as here, a suit is in substance no more than a collateral attack on the award itself, it is governed by the provisions of the Act." *Id.* at 42 (citation omitted). *See also Tamari v. Bache & Co. (Lebanon) S. A. L.*, 565 F.2d 1194, 1202 (7th Cir. 1977), *cert. denied*, 435 U.S. 905 (1978); *Austern v. Chicago Bd. Options Exchange*, 716 F. Supp. 121, 124 (S.D.N.Y. 1989), *aff'd*, 898 F.2d 882 (2d Cir.), *cert. denied*, 498 U.S. 850 (1990).

Appellants contend that, unlike in *Foster*, *supra*, their suit *is* "in substance . . . more than a collateral attack on the [arbitration] award itself . . . ." They claim that they do not seek to disturb the $40,000 award in their favor; the damages they request do not stem from the underlying conduct of Shearson that appellants agreed to arbitrate, but from Shearson's independent acts in allegedly corrupting the arbitration process. Without the damages a court may award them in the present suit, appellants contend, they cannot be made whole by merely repeating the arbitration process — the sole remedy specified by statute — and Shearson will have suffered nothing but litigation expenses by unsuccessfully gambling (as appellants view it) on the outcome of an unfair proceeding.

We disagree and conclude, as did the court in *Corey*, that appellants have essentially brought an impermissible collateral attack on the arbitration award even though they are "requesting damages for the acts of wrongdoing rather than the vacation . . . of the arbitration award." 691 F.2d at 1213.[9]

[9] Appellants' reliance on *Blumenthal v. Merrill Lynch, Pierce,*

Shearson is assuredly correct in arguing that what appellants seek, in critical part, is "to augment and modify the relief granted them by the arbitrators in their award." The principal measure of the injury appellants allegedly suffered from Shearson's deception and unfair dealing was the arbitration award they would have received but for that conduct, less the actual award. The remedy furnished by the statute redresses that injury by providing a new arbitration hearing. It is true that the statute makes no provision for costs, attorney's fees, or other damages (including exemplary) to compensate the party victimized by the tainted award. But, contrary to appellants' argument, this provides an insufficient basis for relieving them of their failure to pursue the remedy specified by the statute.

First, appellants have not persuaded us that either the arbitration statute or the policies underlying arbitration would prevent a new arbitration panel from devising remedies that take into account a party's fraud in the vacated proceeding. Courts have recognized the authority of arbitrators to impose sanctions, presumably including costs and attorney's fees, for misconduct such as discovery abuses revealed during the arbitration proceeding. *E.g.*, *Forsythe Int'l, S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1023 n.8 (5th Cir. 1990) ("Arbitrators may . . . devise appropriate sanctions for abuse of the arbitration process"); *Bigge Crane & Rigging Co. v. Docutel Corp.*, 371 F. Supp. 240, 246 (E.D.N.Y. 1973) ("[A]rbitrators . . . may be able to devise sanctions if they find that [a party] has impeded or complicated their task by refusing to cooperate in pretrial disclosure of relevant matters"). We do not see why that authority should vanish when the wrongdoing has been concealed from the arbitrator but discovered by a court, which then orders a new hearing. Nor

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Fenner & Smith, Inc., 910 F.2d 1049 (2d Cir. 1990), is misplaced because the alleged misconduct in that case — the obtaining of a wrongfully-issued injunction by Merrill Lynch — took place in a judicial proceeding separate from the arbitration, not within the arbitration proceeding itself.

have appellants demonstrated why the regime under which they chose to arbitrate bars a remedy within the arbitration for after-discovered misconduct. Under NASD'S Code of Arbitration Procedure, a member such as Shearson must ("shall") "upon the demand of [a] customer" agree to arbitrate "any dispute, claim or controversy arising out of" the member's business. Appellants' original Statement of Claim, which Shearson agreed to arbitrate, asked for damages that included "punitive damages, interest, costs and attorney's fees." Appellants have shown us no reason why, assuming they had succeeded in vacating the award under the statute, Shearson as an NASD member would not have been required to arbitrate an *amended* claim by appellants asserting both the original damages and those arising from Shearson's (by then confirmed) misconduct in the first proceeding. The suggestion that the arbitrators would have been obliged to ignore antecedent events in arriving at an award seems to us quite implausible.

But even laying this possibility aside and conceding for argument's sake that, absent express agreement of the parties, arbitrators lack authority to grant remedies coextensive with the damages a court may award, we nonetheless are unwilling to permit an action which the arbitration statutes and cases interpreting them foreclose. Appellants agreed to arbitration in the first place rather than a suit in court. They did so knowing (or constructively knowing) that the statute specifies a remedy for misconduct in the arbitration process. They were further aware, or should have been aware, of the time limit for such claims and of the possibility that, while arbitrators have considerable "flexibility in fashioning remedies," *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 357 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985), those measures may not be identical to the remedies a court may order. *See Garrity v. Lyle Stuart, Inc.*, 386 N.Y.S.2d 831, 832 (N.Y. 1976) (while arbitrators "generally are free to fashion the remedy appropriate to the wrong, . . . an authentic remedy is compensatory and measured by

the harm caused"; "strong policies," on the other hand, "confine to the State and its courts the infliction of punitive sanctions on wrongdoers"). Parties elect arbitration, and are encouraged to do so, because of the "manifold" advantages such proceedings offer, *i.e.*:

> [speed and economy], informality, the possibility of coordination with other modes of conciliation, and the ability to preselect the location of, a set of procedural rules or substantive law governing, or even the language to be used in, dispute resolution.

Hanes Corp., 174 U.S. App. D.C. at 265, 531 F.2d at 597. And the statutes governing arbitration stand as a protection against corruption of those proceedings. Allowing parties to arbitration to secure those advantages and yet to pursue damages in court for alleged unfairness in the arbitration process would, we conclude, exceed the limited scope of proper judicial intervention in this area.[10]

Affirmed.

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[10] There is no merit to appellants' remaining contention that Shearson, in moving to dismiss their complaint, relied on exhibits outside the pleadings and thus exceeded the lawful scope of a Rule 12 (b)(6) motion to dismiss. Shearson's motion attacked the legal sufficiency of the complaint, a proper ground for dismissal under Rule 12. Further, each exhibit attached to the motion had been referred to in the complaint, so Shearson did not rely on matters outside the complaint to support its motion. *See* 5 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1327 at 762-63 (1990) ("[W]hen plaintiff fails to introduce a pertinent document as part of his pleading, defendant may introduce the exhibit as part of his motion attacking the pleading."); *see also Feinman v. Schulman Berlin & Davis*, 677 F. Supp. 168, 170 n.3 (S.D.N.Y. 1988) (document referred to in pleadings but not attached thereto properly considered in motion to dismiss; document found to be incorporated by reference in complaint).

Nor did the trial judge improperly deny appellants leave to amend their complaint. No amendment would have altered the fact that appellants' exclusive remedy lay within the arbitration statute.